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IN THE

Supreme Court of the United States

October Term, 1904.

No. 282.

WESTERN TIE & TIMBER COMPANY, Appellant,

vs.

BEN A BROWN, Appellee.

STATEMENT, BRIEF AND ARGUMENT FOR APPELLANT.

GEO. M. BLOCK,
F. H. SULLIVAN,
CHARLES BIRD,
For Appellant.

JOSEPH WHELESS,
Of Counsel.

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1904.

No. 232.

WESTERN TIE & TIMBER COMPANY, Appellant,

vs.

BEN A BROWN, Appellee.

Statement, Brief and Argument for Appellant.

STATEMENT.

On the 24th day of February, 1903, on his voluntary petition to that end, S. Frank Harrison was adjudicated a bankrupt by the District Court of the United States for the Northern Division of the Eastern District of Arkansas (pr. 1-2), and the appellee, Ben A. Brown, is the acting trustee of his estate in that proceeding. Appellant, Western Tie & Lumber Company, proved a claim against the estate for money loaned, founded in part on the bankrupt's promissory note for $22,154.26, and partly on book account, on which latter a balance was

claimed to be due of $2,093.04, after crediting certain items among which were items termed "deductions from pay roll" (pr. 2-5). The trustee moved to expunge the entire claim on the ground that appellant had been the recipient of a preference from the bankrupt (pr. 5). This motion having prevailed in the District Court, appellant removed the cause by appeal into the United States Circuit Court of Appeals for the Eighth Circuit where a judgment was entered, March 28, 1904, modifying the judgment below and affirming it as modified, and directing that appellant's entire demand be expunged unless it surrendered to the trustee $2,135.73 (pr. 14). Appellant thereupon in due time filed its petition for appeal, its assignment of errors and bond and was allowed an appeal to this Court from the Circuit Court of Appeals (pr. 15-18), citation being issued and duly served (pr. 19).

The Circuit Court of Appeals, in accordance with the rule of this Court in that behalf, made and filed its finding of facts and conclusions of law (pr. 7-8) in which, after finding the adjudication and proof of appellant's claim, the order expunging it and the appeal therefrom hereinefore recited, it was found that for some months prior to the adjudication, appellant and the bankrupt had been engaged in removing timber from land owned by appellant and converting it into railway ties which appellant disposed of, and that the bankrupt had owned and conducted stores in the vicinity and furnished supplies to the laborers engaged in the manufacture and handling of the ties. Once in two or four weeks an inspector sent to appellant a pay roll showing the earnings of each laborer and the value of the supplies furnished him by the bankrupt. From such earnings appellant deducted the value of the supplies each laborer had received from the bankrupt, sent the laborer a check for the bal-

ance and at the same time sent the bankrupt a check for the aggregate amount of the supplies he had furnished the laborers. Four months before the filing of the petition in bankruptcy the bankrupt owed appellant more than $20,000.00. Between December 27th, 1902, and February 24th, 1903, appellant refused to pay the bankrupt $2.210.73 due him for supplies furnished to laborers subsequent to November 30th, 1902, and retained the same and credited it on its claim against him. When this occurred the bankrupt was insolvent and appellant knew the fact and "intended by retaining these amounts to secure to itself a preference," but the bankrupt had no such intention, and in the opinion of that court (pr. p. 12), it is shown that when the bankrupt delivered the goods he expected and intended to receive payment therefor from the appellant in accordance with the course of prior dealings between them. (A subsequent advance by appellant to the bankrupt of $75.00, not here involved, was also alluded to.)

As conclusions of law the Court found:

A. The retention by appellant of the $2,210.73 constituted a voidable preference under the bankrupt law as amended.

B. The trustee was entitled to have the claim expunged unless appellant surrendered $2,135.73 to the trustee, this amount being the amount so retained, less $75.00 found to have been subsequently advanced.

SPECIFICATIONS OF ERROR.

In its assignment of errors (pr. 16-17) appellant specified errors as follows:

1. The sale of supplies by the bankrupt to the employes of appellant was not a transfer of property to appellant under the act, so as to constitute a preference.

2. The sale of supplies to such employes by the bankrupt and the deduction from their wages of the value thereof by appellant did not constitute a transfer of property by the bankrupt as a preference within the meaning of the Statute.

3. Because on the facts as found by the Circuit Court of Appeals the bankrupt had no intention to prefer appellant, and without such intention on his part his sale of goods to employes of appellant would not constitute a voidable preference in favor of appellant.

4. That which the Circuit Court of Appeals holds to be a preference was the act of appellant in failing and refusing to pay the bankrupt the sums deducted from the wages of its employes, on account of their indebtedness to the bankrupt, and the failure and refusal to pay such sums to the bankrupt was not receiving or obtaining a preference within the meaning of the act.

5. On the facts as so found the act of appellant in making these deductions from the wages of its employes, created an indebtedness from appellant to the bankrupt and neither the failure nor refusal to pay such indebtedness constituted obtaining or receiving a preference within the meaning of the Act.

6. On the finding of facts the indebtedness of appellant to the bankrupt because of such deductions, and the indebtedness of the bankrupt to appellant constituted mutual debts and mutual credits within the meaning of the act and should have been set off one against the other and the balance allowed against the estate.

BRIEF.

I.

This court has jurisdiction of this appeal upon the finding of facts and conclusions of law below.

Act of 1898, Section 25-b;
General Orders in Bankruptcy, XXXVI;
Pirie vs. Chicago Title & Trust Co., 182 U. S. 438;
New York County Bank vs. Massey, 192, Ib. 138.

II.

The bankrupt had no intention to prefer appellant, and without such intention on his part there could be no preference arising from his sale of goods to appellant's employes.

Act of 1898, Section 57-g, as amended Feb. 5, 1903;
Ib. Section 60-b;
Act of 1841, Section 2;
(Act of 1867) Rev. Stat. U. S., Section 5128;
(Ib.) Ib. Section 5084;
Buckingham vs. McLean, 13 How. 169;
Wilson vs. City Bank, 17 Wall. 487;
Clark vs. Iselin, 21 Ib. 375;
Barbour vs. Priest, 103 U. S. 293;
Rice vs. Grafton Mills, 117 Mass. 228.

III.

The sale of the supplies here in question, by the bankrupt, resulted in an indebtedness from appellant to him, was not payment of nor security for, appellant's

demand, and hence was not a preference, but a case of mutual debts to be set off, the one against the other.

Opinion of Circuit Court of Appeals, Pr. p. 11;
Hendrick vs. Lindsay, 93 U. S. 149;
Hecht vs. Caughron, 46 Ark. 132;
Century Digest Vol. II, Tit. Contracts, Sec. 798;
Act of 1898, Section 1 (25);
Ib. Section 68;
New York County Bank vs. Massey, *supra.*

ARGUMENT.

I.

This appeal from the Circuit Court of Appeals falls within subdivision b of Section 25 of the Act of Congress pertaining to bankruptcy in that the amount in controversy exceeds Two Thousand Dollars ($2,000.00) and the rights claimed by appellant for the allowance of its claim and for a set-off of the items, because of which it was expunged and the claim of the trustee that these items constituted a preference under the act, are asserted under the statutes of the United States, and hence there is presented a question within the jurisdiction of this Court upon writ of error to the highest courts of the States. Hence, also, in compliance with Rule XXXVI. of the General Orders in Bankruptcy the Circuit Court of Appeals was asked to, and did, file its finding of facts and conclusions of law, and the evidence upon which such findings were made up has been omitted from the transcript of the record brought to this Court.

The case of Pirie vs. Chicago Title and Trust Company, 182 U. S. 438, presented exactly the same situa-

tion as this case. There, as here, a claim had been allowed against the bankrupt estate, a motion filed to reconsider and disallow it, on the ground that the creditor had received a preference. The referee had so ordered. This ruling was reviewed and affirmed by the District Judge, an appeal was taken to the Circuit Court of Appeals, and upon its judgment of affirmance, the creditor asked and obtained its finding of facts and conclusions of law, and had his appeal allowed in that Court to this, and this Court accepted jurisdiction and disposed of the merits of the controversy.

The case of New York County National Bank vs. Massey, 192 U. S. 138, was another case where the trustee moved to expunge a claim which was offered for proof against the estate because of an alleged preference and an appeal was had upon findings of fact and conclusions of law from the Circuit Court of Appeals to this Court.

The terms of the Statute and the practical interpretation of it in the two cases referred to, seem to place beyond controversy the jurisdiction of this Court to review this decree in the manner in which it is here sought, and we therefore pass to the merits of the controversy.

II.

The adjudication of bankruptcy in this case occurred February 24, 1903, and consequently the Act of 1898, with the amendments of February 5, 1903, control its disposition. Section 57-g of the Act, as thus amended, and as far as material here, reads as follows:

> "The claims of creditors who have received preferences *voidable under section sixty, subdivision b.* * * * shall not be allowed unless such creditors shall surrender such preferences."

The addition by the Act of February 5, 1903, being here quoted in italics.

This amendment was doubtless brought about by the decision of this court in Pirie vs. Chicago Title and Trust Company, *supra*, in which was pointed out the distinction, under the original enactment, between a preference simply, and a *voidable* preference (in the language of the amendment).

The Circuit Court of Appeals found as a fact that the bankrupt in this case had no intention to prefer appellant, and held that no such intention on his part was necessary to an order disallowing appellant's demand. Under the section just quoted, to deny proof of a claim because of a preference, the latter must be "voidable under section 60, subdivision b."

This statute provides:

> "If a bankrupt shall have given a preference and the person receiving it or to be benefitted thereby * * * shall have reasonable cause to believe *that it was intended thereby to give a preference*, it shall be voidable by the trustee," etc.

As stated, the Circuit Court of Appeals was of opinion that, under this statute, the intent necessary to avoid the transaction need not be held by the bankrupt, but might be held by the creditor alone, with the same resulting invalidity. In the Pirie case, as well as in the case of the New York County Bank, *supra*, this court pointed out the necessity of a plain interpretation of plain provisions of the Act, saying in the latter case that the courts are to interpret the statute, not to add to it. The language of this part of the Act requires that the creditor have reasonable cause to believe that it was thereby intended to *give* (not receive) a preference. That this language, according to its plain import, is only applicable to the in-

tention of the debtor, is self evident. The debtor *gives* a preference, the creditor *receives* one. The Court of Appeals applied the Act as though it provided for avoiding a preference as against any person "intending to receive a preference, or having reasonable cause to believe that the intention was to give such." It is respectfully submitted that this is not interpreting, but making, a statute, contrary to the rule of construction promulgated in the New York County Bank case. The illustration which the Court of Appeals adverted to—a preference obtained by judgment and execution, as furnishing proof of the fact that there might be a preference without such an intent on the part of the debtor—lends no support to the views advanced. Preferences obtained by legal process are controlled by section 67, subdivisions c and f, and under their terms all such are avoided by the adjudication *without reference to the intent of the debtor*, and indeed, in practical effect, without reference to the intent of the creditor, as well. Section 60 b, of the Act, has suffered no amendment since the original enactment, save with reference to the jurisdiction of the bankruptcy courts. The language of the Act on this question of intention stands now as it did at the beginning. And there is not, in the Act of 1898, such a departure in this regard from the language of earlier statutes, as to call for an interpretation upon the later Act, differing from that given those preceding. The inhibition in the Act of 1841 (Sec. 2) was against transfers "in contemplation of bankruptcy" and "for the *purpose* of *giving* * * * a preference."

In Buckingham vs. McLean, 13 How. 151, which arose under this statute, opinion by Mr. Justice Curtice, it was held, at page 168 et seq., that the acts forbidden could not be avoided without proof that the debtor contem-

plated his bankruptcy and *designed and intended* a preference.

The Act of 1867 contained similar provisions. Section 35 (Rev. St. Sec. 5128) avoided transfers "with a view to *give* a preference," while Sec. 23 (Rev. St. Sec. 5084) forbade a creditor receiving such a transfer to prove his claim.

In Toof vs. Martin, 13 Wall. 40, Mr. Justice Field delivered the opinion of the Court, and the entire language of the opinion on this question (page 48) shows that the intent of the *bankrupt* is the subject matter to be inquired about.

In Wilson vs. City Bank, 17 Wall. 473, at page 483 et seq., Mr. Justice Miller, in discussing these provisions of the Act of 1867, said:

> "What then is the true meaning of the act? In both cases it must be accompanied with an intent. In Section 35 it is to give a preference to a creditor. In Section 39 it must be to give a preference to a creditor or to defeat or delay the operation of the bankrupt act. In both there must be the *positive purpose* of doing an act forbidden by statute, and the thing described must be done in the promotion of this unlawful purpose."

In Clark vs. Iselin, 21 Wall. 360, at page 375, Mr. Justice Strong said, in discussing the question of preferences, under the Act of 1867:

> "The debtor must be insolvent, or contemplating insolvency, when the alleged preference is given, *and he must then have in view giving a preference.*"

It was also said, in that case, that the *bankrupt* must have "*a present intention to prefer a creditor*" to avoid a transfer. Of course, a requirement of reasonable cause

to believe in an intention to give a preference, by necessary implication requires the existence of such an intention, as one can not be said to have reasonable notice of a fact or condition, unless this fact or condition exists.

In Barbour vs. Priest, 103 U. S. 293, at page 296, Mr. Justice Miller said of a transfer under the provisions of the Act of 1867:

> "Such person (the grantee) must have reasonable cause to believe that the grantor in the conveyance was insolvent at the time it was executed, *and* that it was made with intent to defeat the bankrupt law. *Both these must exist* as facts which the grantee had reasonable cause to believe."

It is thus made to appear that the expressions, "for the purpose of giving a preference," in the Act of 1841, and "with a view to give a preference," in the Act of 1867, have been uniformly held to relate to the purpose and intention of the *bankrupt*. The difference between these former acts and the Act of 1898, lies merely in the substitution of the word "*intended*" in the later act. The significance is identical. And it must be taken that Congress had in mind the interpretation of the prior statutes, and intended the similar language of the present Act to receive a similar construction.

The case of Rice vs. Grafton Mills, 117 Mass. 228, involves the precise question here under discussion, upon facts strikingly similar. One Smith maintained a supply store, and the defendant, Grafton Mills, delivered to him a paper writing authorizing him to furnish its employes with money or supplies in amounts limited by the wages earned, and to render his account monthly to defendant for such advances. About the time he opened business the defendant loaned him a sum of money which it car-

ried in book account against him. For more than a year Smith supplied defendant's workmen and was paid by defendant monthly, for such supplies. Smith was adjudicated a bankrupt in October, 1870. Defendant retained and credited to him, on its demand, the value of the supplies furnished by him in July and August preceding, and the action was by his assignee to recover for such goods. There was evidence tending to show that the bankrupt was insolvent in July and August and that the defendant had reasonable cause to believe that such was the fact.

Smith testified that when he delivered the goods he expected the defendant to pay him for them, and did not know they were not going to do so until afterwards. The defendant requested a charge that if the bankrupt expected at the time he furnished the goods that defendant would pay him for them the verdict should be for the defendant. This the trial court refused, but charged that, if the defendant had the option to apply the goods to a pre-existing debt, and Smith was insolvent and knew it when he delivered the goods, the assignee could recover, notwithstanding the fact that Smith may have expected and supposed that he would be paid for the goods.

For the error in refusing the first request, and in giving the second, above summarized, the Supreme Judicial Court of Massachusetts reversed the judgment, holding that an intent to prefer was essential, and that *unless the bankrupt had such an intention when he delivered the goods there could be no recovery*, citing in support of its views, the opinion of this court in Toof vs. Martin, *supra*.

The finding of facts in this case shows that the bankrupt had no intention to prefer appellant, and consequently the Circuit Court of Appeals was in error in hold-

ing that there had been a voidable preference which appellant must surrender, as a condition precedent to proving its demand.

III.

The findings in this case are rather meager as to the relations of the parties with reference to supplies furnished by the bankrupt to the laborers. Whether the bankrupt had *carte blanche*, without limitation, to furnish such upon the direct responsibility of appellant; whether the liability of appellant was limited in each instance to the amount earned by the laborer supplied, or whether the liability of appellant for such supplies attached only when, with the consent of the particular laborer, the deduction had been actually made from his earned wages, is not made clear. It is immaterial, however, to ascertain which was the arrangement, because it is shown that appellant actually deducted the amounts under consideration from the wages of the laborers, and thereby, under either arrangement, its liability to the bankrupt for the aggregate of the amounts so deducted became fixed. The opinion of the Circuit Court of Appeals (Pr. p. 11) was that appellant became so liable to the bankrupt when the goods were sold. Be that as it may, it is certain that such a liability ultimately was established, and it seems clear that the bankrupt might have had his action of *indebitatus assumpsit* against appellant for the amount thereof. This was clearly the view of the Circuit Court of Appeals and is supported by the decision of this court in Hendrick vs. Lindsay, 93 U. S. 143, to the effect that appellant's deductions implied a promise to pay the bankrupt. And the rule prevailing in Arkansas, where these matters arose, is that a promise to one for the benefit of another gives a right of action upon such promise to the person for whose benefit it is made

(Hecht vs. Caughron, 46 Ark. 132); and such is the overwhelming current of American authority. See Century Digest, title "Contracts," Section 798, where the decisions on this subject are collated. Upon any view of the facts there was implied from the course of dealings prevailing, a promise on the part of appellant to pay the bankrupt the amounts deducted from the wages due its employes. In other words, and, in any event, upon the making of the deductions, appellant became indebted to the bankrupt therefor, and the relations of the parties were then that of debtor and creditor, inasmuch as the finding of facts negatives the possibility that the bankrupt made the sales, intending them as a payment on his indebtedness to appellant. This is shown by the conclusions of law announced below (Pr. 8) to the effect that it was the retention of these deductions which constituted the voidable preference. In other words, the preference, according to the view below, was *the failure and refusal to pay a debt*. Upon these facts the case of *New York County National Bank vs. Massey, supra*, is controlling authority and establishes that under a proper construction of the act, the case presented is that of mutual debts, to be set off one against the other, rather than a case of a preference. In that case the bankrupts were indebted to the bank upon sundry bills, and also maintained a general deposit account with it. The adjudication was on January 27th, and they made deposits of different amounts to their credit, on the 22nd, 23rd and 25th of the same month. One, at least, of these was after the bank had notice of their insolvency. The bank applied the balance standing to the credit of the bankrupt, on account of these deposits, to the payment of the bills, and offered to prove its claim for the resulting balance in its favor. The Circuit Court of Appeals for the Second Cir-

cuit, held these facts to show a preference. It was contended in that Court that under the terms of Section 1 (25) of the Act, the transfer of these funds was not a preference, because neither a payment, pledge, mortgage, gift, or security, but that Court was of opinion that these words in the definition of a transfer were merely by way of illustration and not of limitation (116 Fed. 342). Upon a finding of facts by that Court, the cause was brought here by appeal, and this Court reversed the judgment of the Circuit Court of Appeals, and affirmed that of the District Court allowing the claim. The two sections of the Act which were particularly involved were Section 1 (25), reading as follows:

> "Transfer shall include the sale and every other and different mode of disposing of or parting with property or the possession of property, absolutely or conditionally, *as a payment, pledge, mortgage, gift or security.*"

And section 68 of the Act, reading as follows:

> "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor, the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

The opinion of this court, by Mr. Justice Day, may be briefly summarized as follows:

1. Section 1 (25) must be read with sections 57-g and 60-a, and no transaction is a preference which is not either payment, pledge, mortgage, gift or security.

2. The deposits in the bank created an equivalent indebtedness from the bank to the depositor, and hence worked no diminution of the estate of the depositor.

3. There were mutual debts between the bankrupt and the bank, on account of these bills payable and de-

posits, which, under the terms of Section 68, should be set off one against the other.

It was said in that case:

> "We are to interpret statutes, not to make them. Unless other sections of the law are controlling, or, in order to give a harmonious construction to the whole act, a different interpretation is required, it would seem clear that the parties stood in the relation defined in Sec. 68-a, with the right to set off mutual debts, the creditor being allowed to prove but the balance of the debt."
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> * * * * * * *
>
> "But it is urged that under Sec. 60-a this transaction amounts to giving a preference to the bank, by enabling it to receive a greater percentage of its debts, than other creditors of the same class. A transfer is defined in Sec. I (25) of the act to include the sale and every other and different method of disposing of or parting with property or the possession of property, absolutely or conditionally, as a payment, pledge, mortgage, gift, or security. While these sections are not to be narrowly construed so as to defeat their purpose, no more can they be enlarged by judicial construction to include transactions not within the scope and purpose of the act. This section, I (25), read with Secs. 57-g, and 60-a, requires the surrender of preferences having the effect of transfers of property 'as payment, pledge, mortgage, gift, or security which operate to diminish the estate of the bankrupt and prefer one creditor over another.'"
>
> "The law requires the surrender of such preferences given to the creditor within the time limited in the act before he can prove his claim. These transfers of property, amounting to preferences, contemplate the parting with the bankrupt's property for the benefit of the creditor, and the consequent diminution of the bankrupt's estate.

It is such transactions, operating to defeat the purposes of the act, which, under its terms, are preferences."

"As we have seen, a deposit of money to one's credit in a bank does not operate to diminish the estate of the depositor, for when he parts with the money he creates at the same time, on the part of the bank, an obligation to pay the amount of the deposit as soon as the depositor may see fit to draw a check against it. It is not a transfer of property as a payment, pledge, mortgage, gift, or security. It is true that it creates a debt, which, if the creditor may set it off under Sec. 68, amounts to permitting a creditor of that class to obtain more from the bankrupt's estate than creditors who are not in the same situation, and do not hold any debts of the bankrupt subject to set-off. But this does not, in our opinion, operate to enlarge the scope of the statute defining preferences so as to prevent set-off in cases coming within the terms of Sec. 68-a. If this argument were to prevail, it would, in cases of insolvency, defeat the right of set-off recognized and enforced in the law, as every creditor of the bankrupt holding a claim against the estate subject to reduction to the full amount of a debt due the bankrupt receives a preference in the fact that, to the extent of the set-off, he is paid in full."

The parallel between that case and this is well-nigh perfect. There, as here, the transfer was not payment, pledge, mortgage, gift, or security; there, as here, the transfer resulted in creating an indebtedness to the bankrupt equivalent to the thing transferred and hence resulted in no diminution of the bankrupt's estate; there, as here, the actual preference resulted from the set off of mutual debts, which, as was said by this Court, *supra*, is a necessary result of the enforcement of Section 68 of the Act.

The opinion of this Court in the *New York County Bank* case, while promulgated, had not been published, when this case was determined in the Circuit Court of Appeals, and hence was not presented to that Court, otherwise this appeal would, probably, have been unnecessary, as the opinion in that case seems clearly to control this one, and to require the reversal of the judgment of the District Court and of the Circuit Court of Appeals, and the remand of the cause with directions to allow appellant's demand against the estate.

Respectfully submitted,

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